> The term "affiliate" means a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person. For purposes of this paragraph, the term "own" means to own an equity interest (or the equivalent thereof) of more than 10 percent.[119]

40. In considering whether the proposed merger of Bell Atlantic and GTE would result in a violation of the Communications Act, we must first determine whether Genuity (following its proposed spin-off from GTE) would be owned or controlled by the merged entity within the meaning of section 3(1) because such ownership or control would render Genuity an "affiliate" of the merged entity.

1. Ownership

41. For the reasons set forth below, we conclude that Bell Atlantic/GTE will not own Genuity within the meaning of section 3(1) of the Act. We find that, prior to exercise of its conditional conversion right to acquire additional shares, Bell Atlantic/GTE will not directly or indirectly own an equity interest or its equivalent in Genuity of greater than 10 percent. First, we establish that an equity interest under section 3(1) can include conditional conversion rights. Second, we apply a three-part test to determine whether the conversion right at issue should be deemed an equity interest or its equivalent. Under the facts of the instant proceeding, we conclude that it should not.

a. Statutory Meaning and History of "Equity Interest" and its "Equivalent"

42. In defining the term "affiliate," section 3(1) specifies that "[f]or purposes of this paragraph, the term 'own' means to own an equity interest (or the equivalent thereof) of more than 10 percent."[120] The terms "equity interest" and the "equivalent thereof" are not defined in section 3(1) or elsewhere in the Act. The issue in this case is whether Bell Atlantic/GTE's retention of Class B shares, comprising 9.5 percent of Genuity's outstanding shares and carrying a potential right to convert into newly-issued shares representing up to 80 percent of Genuity upon satisfaction of certain conditions, represents "an equity interest (or the equivalent thereof) of more than 10 percent."[121] We therefore must determine whether the merged entity's conditional conversion right should be considered an equity interest or its equivalent that is presently attributable to Bell Atlantic/GTE or whether this right does not become an equity interest or its equivalent until exercised. To answer this question, our first step is to determine

[119] 47 U.S.C. § 153(1).

[120] 47 U.S.C. § 153(1).

[121] All parties agree that Bell Atlantic/GTE's outright ownership of shares representing 9.5 percent of Genuity plainly constitutes an "equity interest" in Genuity. Parties disagree, however, on whether the potential right to convert those Class B shares upon satisfaction of certain conditions would itself fall within the meaning of "equity interest (or the equivalent thereof)," thereby potentially bringing Bell Atlantic/GTE's equity holdings above the 10-percent statutory restriction.

whether the terms "equity interest (or the equivalent thereof)" include conditional interests.

43. Both the Applicants and AT&T have asserted facially plausible, yet opposing, meanings for the terms "equity interest" and its "equivalent." The Applicants interpret these terms narrowly and argue that a conversion right, or an option to acquire an equity interest in the future, is not an "equity interest" prior to conversion if it confers none of the three legal rights that, they contend, traditionally attend equity ownership: to vote, to participate in corporate earnings, and to participate in dissolution proceeds.[122] This interpretation, they maintain, is supported by the statute's use of the present tense ("owns," "is owned," and "is under common ownership"), which they claim evidences that Congress intended to capture only current possession of equity interests, not interests that give rise to an equity interest in the future.[123] In further support of their interpretation, the Applicants cite the treatment of options in other contexts, including bankruptcy and accounting principles,[124] in court cases construing the notion of equity ownership and the rights conferred through options,[125] and Fletcher's Cyclopedia, which states that "[a]n option to purchase stock does not vest in the prospective purchaser an equitable title to, or any interest or right in the stock."[126]

44. Conversely, AT&T and other commenters interpret these terms broadly, contending that the term "equity interest" plainly encompasses a conversion right embedded in an underlying equity security, as well as other convertible interests such as standalone options.

[122] Bell Atlantic/GTE May 9, 2000 Reply at 13; Bell Atlantic/GTE Feb. 22, 2000 Reply at 4, Ex. A at para. 15 (Declaration of Ronald J. Gilson). *See also* Fletcher's Cylopedia § 5081 (defining "proprietary interests in a corporation" as generally including "(1) a right to exercise some control over the corporation's management, (2) a right, upon dissolution, to share in any residual proceeds from liquidation of the assets, and most important (3) a right to share in the corporation's residual earnings.").

[123] Bell Atlantic/GTE May 9, 2000 Reply at 13 (*citing Sutton v. United Air Lines*, 119 S. Ct. 2139, 2146 (1999) (holding that a statute defining "disability" in the "present indicative verb form" requires that a person "be presently – not potentially or hypothetically – substantially limited" in a major life activity)).

[124] *See, e.g.*, Bell Atlantic/GTE May 9, 2000 Reply at 21 (*citing In re Motels of America, Inc.*, 146 B.R. 542, 544 (Bankr. D. Del. 1992) (under bankruptcy law, a holder of a share of stock stripped of voting rights and not freely transferable is not considered an "owne[r]" of "equity"). The Applicants also claim support from the Hart-Scott-Rodino reporting requirements, under which the mere acquisition of an option, warrant or similar convertible interest, in contrast to its later conversion or exercise, does not trigger merger review. Bell Atlantic/GTE May 9, 2000 Reply at 15 (*citing* 16 C.F.R. § 802.31).

[125] *See* Bell Atlantic/GTE May 9, 2000 Reply at 14 (*citing Ball v. Overton Square, Inc.*, 731 S.W.2d 536, 540 (Tenn. Ct. App. 1987) ("[A]n option to purchase stock does not vest in the prospective purchaser an equitable title to, or any interest or right, in the stock."); *Association of Flight Attendants v. USAir, Inc.*, 24 F.3d 1432, 1435 (D.C. Cir. 1994) ("USAir has no present equity interest in Shuttle, but it has an option to purchase a controlling interest in the company effective October 10, 1996."); *Powers v. British Vita, P.L.C.*, 969 F. Supp. 4, 5 (S.D. N.Y. 1997) ("Many cases hold that an option contract does not qualify as an equity interest.")).

[126] Fletcher's Cyclopedia § 5575. According to Fletcher's, "[t]he essence of an option is the right of the optionee to buy or not to buy at the optionee's election. The fact that the optionee is not bound to buy is the distinguishing feature of the contract." *Id.*

Specifically, AT&T claims that options are treated as equity under securities law,[127] bankruptcy law,[128] corporate law[129] and financial accounting practices.[130] In particular, AT&T cites the American Law Institute's Principles of Corporate Governance, which defines an "equity interest" as an "an equity security in a corporation,"[131] which in turn is defined to include any instrument "convertible [into] a share in a corporation."[132]

45. The parties also disagree on the scope and meaning of term "equivalent" under section 3(1). The Applicants maintain that the "equivalent" of an equity interest refers to "those arrangements that confer the same (or very similar) participation rights as equity interests."[133] AT&T, on the other hand, interprets the term more flexibly to mean something equal in value or worth. Consequently, AT&T regards as decisional the value that the market would place on Bell Atlantic/GTE's Class B shares, which it asserts would amount to nearly 80 percent of Genuity.[134] We find that both of these positions are plausibly supported by common uses of the term. The first of Black's Law Dictionary's two definitions of the term "equivalent," meaning "[e]qual in value, force, amount, effect, or significance,"[135] could be read to support AT&T's assertion that

[127] AT&T May 5, 2000 Opposition at 18 (*citing* 15 U.S.C. § 78c; 17 C.F.R. § 240.16a-4); *id.*, Ex. A at para. 12 (Third Declaration of John C. Coffee); AT&T Mar. 10, 2000 *Ex Parte* Letter at 3-5 (*citing* federal securities cases); *id.*, Ex. A at paras. 15-17 (Declaration of John C. Coffee).

[128] AT&T May 5, 2000 Opposition at 18 n.16 (*citing* 11 U.S.C. § 101(16); *Allen v.Levy*, 226 B.R. 857, 865 (Bankr. N.D. Ill. 1998) ("The Bankruptcy Code defines 'equity security' as a 'share in a corporation' and includes the right to purchase shares within the definition"); *In re The Charter Company*, 44 B.R. 256 (Bankr. M.D. Fla. 1984)(holding that shares of convertible preferred stock are "equity securities" under the bankruptcy laws)). *But see* Bell Atlantic/GTE May 9, 2000 Reply at 20 (stating that "bankruptcy law treats *some* potential future interests – such as options – like equity for the purpose of prioritizing the holder's economic interest in the estate.").

[129] AT&T May 5, 2000 Opposition at 19 (*citing Entel v. Guilden*, 223 F. Supp. 129, 132 (S.D.N.Y. 1963) ("[W]arrants are used . . . as a separate form of equity in corporations.")).

[130] AT&T claims that options are regarded as common stock equivalents under financial accounting standards. AT&T May 5, 2000 Opposition at 9 (*citing* Financial Accounting Standards Board, Accounting Standard, Accounting Principles Board, Opinion No. 15)). *But see* Bell Atlantic/GTE May 9, 2000 Reply at 22-23 (contending that the FASB opinion cited by AT&T has been superseded by FASB Statement No. 128, under which options are not regarded as common stock equivalents if contingent upon some future event).

[131] American Law Institute, Principles of Corporate Governance § 1.19 (1994).

[132] American Law Institute, Principles of Corporate Governance § 1.20 (1994).

[133] Bell Atlantic/GTE May 9, 2000 Reply at 28-29 (explaining that equity "equivalents" would include devices that conferred the three participation rights through contract or other instruments that carry the distribution and liquidation rights of equity ownership absent voting, such as partnership interests, debt interests that confer the right to participate in earnings, and nonvoting preferred stock). *See also* Bell Atlantic/GTE Supplemental Filing at 35 n.21; Bell Atlantic/GTE Apr. 3, 2000 *Ex Parte* Letter Ex. E at para. 18 (Second Supp. Decl. of Ronald J. Gilson).

[134] Letter from Peter D. Keisler, Sidley & Austin, Counsel for AT&T, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-184 (filed Mar. 10, 2000), at 3 ("Two things are 'equivalent,' of course, if they are equal in value.").

[135] Black's Law Dictionary (7th ed. 1999).

the primary indicia of ownership is the amount of Genuity's value attributed by the market to the Class B shares. By incorporating functional concepts, however, the second definition, "[c]orresponding in effect or function; nearly equal; virtually identical"[136] seemingly supports a more narrow interpretation related to the indicia of ownership asserted by the Applicants (*i.e.*, voting rights, earnings rights and liquidation rights). Other definitions of "equivalent" similarly reference both value and effect.[137]

46. In light of the varying authorities cited by the Applicants and the merger opponents, we reject the parties' contrary assertions that the meaning of the term "equity interest" or its "equivalent" in the context of a conditional conversion right is clear and unambiguous. Our examination of corporate law and the other authorities cited produces no plain meaning of the terms when applied to a conditional conversion right. Although AT&T cites ALI principles, we believe that the ALI definition proves too much in the case of a conditional conversion right. If, for example, a party held a convertible instrument for which the conversion right was expressly conditioned upon something that was nearly certain not to occur, we believe that a bright line principle treating that interest as equity may result in unintended consequences. For this reason, we believe that we must look to other sources to determine a reasonable meaning of "equity interest (or the equivalent thereof)" in the context of a conditional conversion right. Moreover, we believe that if Congress intended that the Commission strictly apply the securities law understanding of an equity interest, reflected in the ALI principles cited by AT&T, it could have indicated as much in the language of the statute. Indeed, in another provision of the Act, Congress did just that and expressly defined "control" as having the same meaning as that term is defined in Securities and Exchange Commission regulations.[138]

47. The issue of whether a conditional conversion right constitutes an "equity interest (or the equivalent thereof)" under section 3(1) presents a novel question for the Commission.[139]

---

[136] *Id.*

[137] Webster's multiple definitions of the term "equivalent" include "equal in value" as well as "corresponding or virtually identical esp. in effect or function." Webster's Third New International Dictionary, (1993). Similarly, the Oxford English Dictionary defines "equivalent" as "[e]qual in value," "[t]hat is virtually the same thing; identical in effect; tantamount," and "[h]aving the same relative position or function; corresponding." The Oxford English Dictionary (Vol. III 1969).

[138] 47 U.S.C. § 274(i)(4) (defining the term "control" as having "the meaning that it has in 17 C.F.R. 240.12b-2, the regulations promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or any successor provision to such section.").

[139] The Commission has never clearly delineated the status of a conditional conversion right under section 3(1). In 1997, the Cable Services Bureau was confronted with the question of whether a multichannel video programming distributor was affiliated with Bell Atlantic or NYNEX, each of whom held shares of convertible preferred stock and jointly held a warrant to purchase additional shares. *Time Warner Cable*, CUID Nos. NY0335 *et al.*, Memorandum Opinion and Order, 12 FCC Rcd. 23363 (CSB 1997). At that time, unlike the permanent rules that adopted a different affiliate definition, the Commission's interim rules regarding the LEC effective competition test of section 623 of the Act applied section 3(1)'s definition of affiliate. 47 U.S.C. § 543(l)(1)(D). *See Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996*, CS Docket No. 96-85, Order and Notice of Proposed Rulemaking, 11 FCC Rcd 5937, 5944 (1996). Without attempting to resolve the definitional issues arising under section 3(1), the Bureau concluded that the interests held by Bell Atlantic and (continued....)

Although the Commission has considered the treatment of options and conversion rights in other contexts, we find that these do not control our analysis of "equity interest" or its "equivalent" under section 3(1). As the Applicants point out, the Commission traditionally has not attributed options, warrants and other convertible securities as current ownership interests under the CMRS spectrum cap rules,[140] the LEC/LMDS cross-ownership rules,[141] the application of section 310's foreign ownership restrictions,[142] and the broadcast[143] and cable[144] attribution rules. We nonetheless agree with AT&T's observation that the "equity plus debt" rule recently adopted as part of the broadcast and cable attribution rules implies that such interests, if of a certain size, may be considered.[145] As AT&T further observes, the Commission's rules for designated entities in spectrum auctions treat options "as if the rights thereunder already have been fully exercised."[146] We find, therefore, that the Commission's treatment of convertible instruments differs depending on the structure and purposes of the specific statute at issue. Insofar as none of precedents cited seek to interpret section 3(1) or the specific terms "equity interest" and its "equivalent," we do not find that any particular precedent is controlling for our purposes. In addition, we note that the equity plus debt rule in the broadcast and cable attribution context seeks to identify not only entities with ownership and control, but also entities with "influence" over a licensee. Further, we note that, unlike the broadcast and cable attribution context, here we are not concerned with promoting localism or a diversity of viewpoints. We conclude therefore that none of these precedents controls our analysis.

(Continued from previous page)
NYNEX did not give rise to an affiliate relationship. Although the Applicants here attempt to rely upon that case as controlling precedent for their spin-off proposal, we find that *Time Warner* is limited to its unique facts and not useful for resolving the question presently before us. The Bureau expressly did not resolve the scope of "equity interest" or its "equivalent" under section 3(1), and, in fact, the Bureau's conclusion rested principally upon the intent of the parties, through a binding agreement, to dispose of their entire interest in the entity in question, something that the Applicants have not expressed an intent to do.

140 Bell Atlantic/GTE Apr. 3, 2000 *Ex Parte* Letter at 8 (*citing* 47 C.F.R. § 20.6(d)(5)).

141 *Id.* (*citing* 47 C.F.R. § 101.1003(e)(5)).

142 *Id.* (*citing BBC License Subsidiary*, File Nos. BALCT-941031KF *et al.*, Memorandum Opinion and Order, 10 FCC Rcd 10968, 10972, para. 20 n.12 (1995); *GWI PCS, Inc.*, File Nos. 00200CWL96, Memorandum Opinion and Order, 12 FCC Rcd 6441, 6445-46, para. 10 (1997)).

143 *Id.* (*citing* 47 C.F.R. § 73.3555, Note 2(b) & (f)).

144 *Id.* (*citing* 47 C.F.R. § 76.501, Note 2(e)).

145 AT&T May 5, 2000 Opposition at 20. *See also infra* Section V.B.1 (discussing "equity plus debt" attribution rules for broadcasting and cable)."

146 24 C.F.R. § 24.709(b)(7). *See also Washington's Christian Television Outreach, Inc.*, File Nos. BPCT-5042, Memorandum Opinion and Order, 94 F.C.C.2d 1360 (1983) (establishing a rebuttable presumption in the context of comparative broadcast hearings, where Commission staff sought to establish a fixed factual base for comparative purposes that viewed the applicant's structure in its most unfavorable light, the Commission would take cognizance of options that are adverse to the applicant's interests "in the absence of evidence that the options will not be exercised.").

48. Thus, employing the traditional tools of statutory construction,[147] we conclude that the undefined terms "equity interest" or its "equivalent," as discussed above, are susceptible to varying interpretations. Neither the text of statute nor the context in which the terms "equity interest (or the equivalent thereof)" are used provide any specific guidance on the characterization of a conditional conversion right.

49. Insofar as the terms are ambiguous, we turn next to the legislative history for guidance. Congress did not specifically address the question of the status of a conditional interest as an "equity interest" or its "equivalent," and we find that the legislative history is ultimately inconclusive. The Applicants contend that Congress intended the term "affiliate" to have the meaning set forth in the MFJ. There is some suggestion that, in adding section 3(1) as part of the 1996 Act, Congress may have derived the definition of "affiliate" from the MFJ and specifically intended it to have the same meaning as under the MFJ. Section IV(A) of the MFJ contained a definition of an "affiliate" that closely parallels section 3(1)'s language, with the only substantive change reflecting a reduction in the percentage of equity ownership from 50 percent in the MFJ to ten percent in section 3(1).[148] Committee Reports from bills that preceded the 1996 Act suggest that the definition of "affiliate" in those earlier bills was drawn from the MFJ and was intended to have the same meaning:

> Section 106 of the bill contains the definitions to the terms used in title I of the Act. The definition of "affiliate" [and other terms relating to the BOC restrictions] are drawn from definitions in the MFJ. The Committee intends that these terms have the same meaning as under the MFJ.[149]

50. While this history is instructive,[150] in the end we find the Applicants' argument that the MFJ controls in interpreting "equity interest" and "equivalent thereof" unpersuasive and that the wholesale adoption of factors employed under the MFJ would be reading too much into the legislative history. The 1996 Act expressly overhauled the MFJ in favor of a pro-competitive and deregulatory regime designed to open all telecommunications markets to competition,[151] and

[147] *See Natural Resources Defense Council, Inc. v. Browner*, 57 F.3d 1122, 1125 (D.C. Cir. 1995) (*quoting Chevron USA Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 n.9 (1984)).

[148] *See United States v. American Telephone and Telegraph Co.*, 552 F. Supp. 131, 228 (D. D.C. 1982) (*Modification of Final Judgment*), at Section IV(A) (stating that "[f]or the purposes of this paragraph, the terms 'ownership' and 'owned' mean a direct or indirect equity interest (or the equivalent thereof) of more than fifty (50) percent of an entity.").

[149] H.R. Rep. No. 559(I), 103d Cong., 2d Sess. 130 (1994). *See also* H.R. Rep. 103-559 (II), 103d Cong., 2d Sess. 227 (1994) (same).

[150] In this regard, we note that the MFJ court drew a distinction between the acquisition of a conditional option and the acquisition of an "equity interest." The Court wrote in *Tel-Optik* that NYNEX "[was] not proposing, at this juncture, acquisition of an *equity interest* in Tel-Optik," but rather that NYNEX had paid for the right to acquire all of Tel-Optik's stock "if certain conditions are met." *See United States v. Western Electric Co.*, No. Civ. A. 82-0192, 1986 WL 11238, at *1 (D.D.C. Aug. 7, 1986) (*Tel-Optik*) (emphasis added and footnote omitted).

[151] *See* 47 U.S.C. § 152 note.

we decline to import into the Act an understanding of the term "affiliate" derived solely from the MFJ.

b. Statutory Purpose and Structure

51. Accordingly, having examined the statutory text, context and legislative history, we decline suggestions by both the Applicants and merger opponents that we adopt a bright-line characterization of conditional interests. Rather, based on the context and relevant legislative history, we can reasonably conclude that the terms "equity interest (or the equivalent thereof)" neither encompass nor exclude all forms of conditional interests. We find that some conditional interests may appropriately be deemed an equity interest or its equivalent, thereby potentially giving rise to an affiliate relationship, while others may not. AT&T's overly broad interpretation, however, could prohibit relationships that involve the potential right to acquire an equity interest, no matter how unlikely the occurrence of the contingency. Similarly, the Applicants' overly narrow interpretation could fail to include some investments that, by their nature, enable the holder to obtain material benefits from conduct that the holder is restricted from engaging in itself, or that give rise to the very incentives that the particular statute at issue is designed to prevent. We note that our recognition that some conditional interests may constitute equity interests comports with the general notion that certain future interests may be attributable under the "equity plus debt" exception to the broadcast and cable attribution rules.[152]

52. For these reasons, we reject either of the bright line tests that the parties have advocated for purposes of section 3(1). Having examined the conflicting corporate law authorities on the record, we are convinced that they do not resolve the question before us. Rather, we conclude that our analysis of whether this contingent interest constitutes an equity interest or its equivalent under section 3(1) should be guided not by any rote application of corporate or securities law jurisprudence, but by the statutory purposes and the structure of the 1996 Act. Indeed, the divergence of authority regarding characterization of conditional interests under other fields of law persuades us that Congress could *not* have intended that we determine the status of conversionary interests, under section 3(1) of the Communications Act, by reference to any single external body of law, given the considerable debate and conflicting views on this question.

53. Therefore, we resolve this issue from the perspective of communications jurisprudence and the statutory purposes underlying the provisions at issue. In making these determinations, we will evaluate, on a case-by-case basis, whether exclusion of the particular conditional interest from the status of an equity interest or equivalent would undermine Congress' intentions. Where failure to treat a specific conditional interest as an "equity interest (or the equivalent thereof)" -- and thus as an "affiliate" -- would thwart the underlying statutory provision in which the term "affiliate" is used, we would find that such a conditional interest constitutes an "equity interest or equivalent." We conclude, therefore, that a close evaluation of

[152] Because these attribution rules are not derived from section 3(1)'s affiliate definition and are designed in part to identify persons with "influence" over the core operations of a licensee, we decline to adopt the bright line 33-percent threshold adopted therein. *See infra* Section V.B.1 (discussion of debt-equity rule).

statutory purposes is an important part of any test for determining the characterization of a conditional interest.

54. Before we examine the purposes of the particular statutory provision, we first must find that the conditional interest at issue is a *bona fide* "conditional" interest. In other words, we must be satisfied that the actual exercise of the option or other conditional interest is sufficiently uncertain that it should not be considered a present equity interest or equivalent. Under this prong of our test, we will examine whether the occurrence of one or more contingencies to the exercise of the option is genuinely in question. If the exercise were virtually certain, then we would deem the interest a present equity interest or equivalent, rather than a *bona fide* conditional interest.

55. A third factor is also critical. Recognizing that the term "affiliate" in section 3(1) is generally invoked in the statute to impose regulatory restrictions that prevent various types of anticompetitive conduct among related entities,[153] we believe an appropriate factor in evaluating the scope of the term is whether the acquisition would increase the likelihood that the acquiring company would discriminate in favor of the company in which it will acquire the conditional interest. Indeed, through the BOC-specific Act provisions, just as during the MFJ years, BOCs are constrained from discriminating, and using their bottleneck control in the local and exchange access markets, to obtain an unfair advantage in the long distance market. Thus, we believe that ensuring that the acquisition of a conditional interest not result in a BOC's using its monopoly position to favor related entities (to its own economic advantage) while discriminating against competitors is plainly relevant and material to our consideration here.

56. In sum, in evaluating whether or not a specific conditional interest constitutes an equity interest or equivalent thereof under section 3(1), we will consider the following three factors: (1) whether the conditional interest is subject to a genuine contingency; (2) whether the interest furthers (or instead undermines) the particular statutory provision at issue; and (3) whether the interest would increase the likelihood that the acquiring company would discriminate in a manner that favors or benefits the entity in which it will acquire the conditional interest.

57. The test we have set forth expressly recognizes that some relationships will result in conditional interests that create an affiliate relationship, while other such interests may not. In this regard, our case-specific evaluation bears some similarity to that applied under the MFJ. In examining the status of a BOC's acquisition of a conditional interest, Judge Greene recognized that not all conditional interests would create relationships that would thwart the BOC line-of-business restrictions with which he was concerned.[154] By establishing a framework for BOC

[153] *See, e.g.,* 47 U.S.C. § 224 (imputation of costs of pole attachment rate); 47 U.S.C. § 251 (interconnection at least equal in quality to that provided by the LEC to itself or to any affiliate); 47 U.S.C. § 260 (complaints alleging discrimination in telemessaging services); 47 U.S.C. § 275 (provision of alarm monitoring services by a BOC).

[154] In *Tel-Optik*, for example, the MFJ Court considered whether NYNEX's purchase of a conditional right to acquire 100 percent of the stock of an undersea cable company would constitute entry into a restricted line of business. *Tel-Optik*, 1986 WL 11238 at *1. *See also United States v. Western Electric Co.*, 894 F.2d 430, 435 n.9 (D.C. Cir. 1990) ("even the appellees concede that not all conditional-interest transactions make the target firm into an 'affiliated enterprise' under Section II(D).").

acquisitions of conditional interests, Judge Greene implicitly recognized that some conditional interests would lead to an "affiliated enterprise" relationship, while others would not.[155] While we consider a different set of factors than those evaluated by Judge Greene, our goals and analyses have aspects in common. Both the MFJ regime and the 1996 Act evidence concerns about BOC use of bottleneck control in the local and exchange access markets to obtain an unfair advantage in the long distance market. Under both the MFJ test and our own, we require that any interests be truly conditional, with genuine contingencies; and we give serious consideration to an acquiring carrier's ability or incentive to discriminate so as to advantage the target company or disadvantage that company's competitors. In the context of construing the 1996 Act and its numerous statutory requirements, however, we must do more, and accordingly we find pivotal to our analysis consideration of whether the interest furthers the purposes of the Act, including the particular statutory provision where the term "affiliate" is used.

58. In analyzing these factors, we recognize, as AT&T points out, that the ambiguous terms "equity interest" and its "equivalent" are found in a general definitional section of the Act, and that the defined term, "affiliate," is used throughout the Act.[156] We therefore believe it is appropriate, in assessing the scope of an ambiguous definition, to examine the instances in which the term is used, and we have made that a requirement of our test. Thus, we believe that the framework we establish today could accommodate for any differences required by the particular statutory provision at issue, to the extent any such differences exist.[157] As noted, however, several of the references to an "affiliate" are in the specific provisions of the Act that pertain to the BOCs, and for that reason the MFJ precedent can be instructive.

2. Analysis of the Applicants' Spin-off Proposal

59. In applying the factors to the Applicants' spin-off proposal, we find on this record that the merged firm's Class B conversion rights are not an "equity interest (or the equivalent thereof)" under section 3(1) of the Act because (i) their conversion rights are genuinely in question, (ii) their interest furthers the statutory purposes by increasing the merged entity's incentive to achieve section 271 compliance throughout the Bell Atlantic territory, and (iii) the

---

[155] Under the established MFJ procedures, prior to acquiring a conditional interest in a prohibited entity, the BOC would need to secure approval from the Department of Justice by showing: "(1) that the investment is relatively minor; (2) that occurrence of the contingency is genuinely in question; and (3) that the Regional Holding Company clearly lacks the ability, the incentive, or both, to disadvantage the target company's competitors." *Western Electric Co.*, 894 F.2d at 435. Following its approval, the Department of Justice would then file the BOC's request and its approval with the court. As Judge Greene emphasized, however, the actual acquisition of an equity interest in the prohibited entity would require approval of the court under the waiver process outlined in section VIII(C) of the decree.

[156] AT&T Mar. 22, 2000 *Ex Parte* Letter at 3, 11. *See, e.g., supra* n.153 (identifying statutory provisions using the term "affiliate"). We note that sections 273 and 274 of the Act contain section-specific definitions of the term "affiliate." 47 U.S.C. §§ 273, 274. In addition, Title VI of the Act contains a different definition of "affiliate" that pertains to cable communications. 47 U.S.C. § 522(2).

[157] We further note that nothing on the record suggests that our analysis of the proposed spin-off would be inconsistent with our treatment of similar interests in the other contexts in which the term "affiliate" is used.

interest will not increase the likelihood that the merged firm would discriminate against Genuity's rivals.

(i) Genuine Contingency

60. Because the likelihood of the contingency's occurrence is inherently related to the nature of the instrument as a bona fide conditional interest, we examine first whether the occurrence of the contingency is genuinely in question. With respect to the Applicants' proposed spin-off, we find that Bell Atlantic/GTE's ability to convert its shares into greater than 10 percent of Genuity's outstanding shares is genuinely in question.

61. As an initial matter, we reject the suggestion that Bell Atlantic/GTE's conversion right is not conditional. First, the terms of the proposed conversion right are conditioned in such a way that the Class B shares may never be convertible into greater than ten percent of Genuity's outstanding shares. If Bell Atlantic/GTE fails to achieve section 271 approval representing 50 percent of Bell Atlantic's total access lines within five years, the Class B shares will be convertible only into ten percent of Genuity's outstanding shares. This 50-percent threshold requirement, as the Applicants point out, entails a risk that the GTE and Bell Atlantic would never be in a position to recoup the value of the initial assets that they contributed by obtaining an equity interest greater than ten percent. Second, the Applicants' proposal contains a significant access line limitation that renders its ability to convert the Class B shares uncertain. If Bell Atlantic/GTE fails to achieve section 271 approval representing 95 percent of Bell Atlantic's access lines in five years, it may receive at most a marketable note, the face value of which is subject to express limitations. Should Genuity decide not to purchase the interests so tendered, a liquidating trustee will sell that interest subject also to limitations on the amount that may be realized by the merged entity. Thus, under the current proposal, Bell Atlantic/GTE will be able to exercise the full conversion rights to obtain more than 10 percent of the equity shares of Genuity only after the merged entity has satisfied the 95-percent threshold.

62. We conclude that the 95-percent access line threshold that the merged firm must achieve in order to exercise the full conversion right represents a genuine contingency.[158] We therefore reject AT&T's argument, premised on an earlier version of the proposal, that the conversion right lacks the element of speculation that characterizes a conditional interest.[159] With respect to the current proposal, nothing in the record suggests that obtaining section 271 approvals representing 95 percent of Bell Atlantic's access lines within five years will be an easy

[158] Because the Commission examines the underlying economic reality and not simply the labels that Applicants attach to various interests, contrary to AT&T's suggestions, we would not likely find that a contingency premised upon the Cubs winning the World Series would present a legitimate conditional interest. AT&T May 5, 2000 Opposition, Ex. A at 4 (Third Declaration of John C. Coffee, Jr.). *See Fox Television Stations, Inc.*, File No. BRCT-940201KZ, Second Memorandum Opinion and Order, 11 FCC Rcd 5714, 5719, at para. 14 (1995) (*Fox II*) (emphasizing that the Commission examines the economic realities and substance of the transactions under review and not simply the labels that the parties attach to their corporate incidents).

[159] AT&T argued under an earlier version of the proposal that the conversion of the Class B shares would be certain to occur. *See* AT&T May 5, 2000 Comments, Ex. A at 3 (Third Declaration of John C. Coffee, Jr.).

task.[160] In this regard, we observe that in the four years following the Act, only one such application has been approved,[161] while several others have been rejected.[162] While we agree with AT&T that section 271 approval in any given state is primarily within Bell Atlantic's control, we do not find that this fact requires us to disregard the contingent nature of the 95-percent threshold. While the tools for satisfying section 271 approval rest with Bell Atlantic, a great variety of factors can impact the ultimate timing of section 271 approval. In particular, even though Bell Atlantic has obtained approval in one state, our review focuses heavily on the performance of a BOC's operations support systems, and Bell Atlantic does not use the same systems in all of its states. In addition, technical issues, such as problems with its systems or other network modifications that are necessary to comply with the BOC's obligations under the Act, might impede the progress made towards compliance. Further, regulatory entities or persons in addition to this Commission are involved in the section 271 process, most significantly various state regulatory entities and the Attorney General (to whose evaluation the Commission must afford "substantial weight"). Therefore, while a BOC does, in the final analysis, hold the key to its own section 271 success, a number of external or technical factors continue to pose challenges to good faith efforts to satisfy the statutory standards that govern section 271 approval by this agency. We believe that, in judging the nature of the contingency, the fact that this Commission must approve section 271 applications covering 95 percent of Bell

---

[160] In the *Ameritech Michigan Order*, the Commission emphasized the complexity of the task before the BOC as follows:

> Complying with the competitive checklist, ensuring that entry is consistent with the public interest, and meeting the other requirements of section 271 are realistic, necessary goals. That is not to say, however, that they are easy to meet or achievable overnight. Given the complexities of the task of opening these local markets to true, sustainable competition, it is not surprising that companies that are earnestly and in good faith cooperating in opening their local markets to competition have not yet completed the task.

Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan, CC Docket No. 97-137, Memorandum Opinion and Order, 12 FCC Rcd 20543, 20556 at para. 23 (1997) (*Ameritech Michigan Order*).

[161] *See Application by Bell Atlantic New York for Authorization under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, Memorandum Opinion and Order, 15 FCC Rcd 3953 (1999) (granting Bell Atlantic's application for section 271 authority in New York).

[162] *See Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, CC Docket No. 98-121, Memorandum Opinion and Order, 13 FCC Rcd 20599 (1998) (*BellSouth Second Louisiana Order*) (denying application); *Application by BellSouth Corporation, et al., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Louisiana*, CC Docket No. 97-231, Memorandum Opinion and Order, 13 FCC Rcd. 6245 (1998) (denying application); *Application of BellSouth Corporation, et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in South Carolina*, CC Docket No. 97-208, Memorandum Opinion and Order, 13 FCC Rcd 539 (1997) (denying application); *Ameritech Michigan Order*, 12 FCC Rcd 20543 (denying application); *Application by SBC Communications Inc., Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Oklahoma*, CC Docket No. 97-121, Memorandum Opinion and Order, 12 FCC Rcd 8685 (1997) (denying application).

Atlantic's access lines prior to it having any right to convert makes this right genuinely contingent as to Bell Atlantic.

63. We do not find that the absence of a payment by the merged firm to convert its right eviscerates the contingent nature of the instrument so as to render the instrument a present equity interest or its equivalent.[163] Although the pre-paid nature of the Applicants' conversion right is not typically present in option arrangements, we do not believe, where a conversion right is otherwise contingent, that paying for that right up front will automatically render it a present interest.[164] The up-front payment does not change the fact that the conversion right may never be exercised. The 95-percent access line threshold in the Applicants' proposal provides sufficient assurance that the full conversion right may never be exercised, regardless of any payment required for actual conversion.

64. We also find unavailing arguments by merger opponents that because the conversion right could be sold for value after the merged entity met the 50-percent threshold, it should therefore be characterized as equity. That argument is not persuasive in light of the terms of the current proposal.[165] Specifically, under the proposal that we consider herein, we find that, if the conversion right were exercised between 50 and 95 percent, it would most properly be characterized as debt, not equity. The Commission, in other contexts, has established criteria to distinguish bona fide debt from equity that examine (1) whether there is a written unconditional promise to repay the money on demand and to pay a fixed rate of interest; (2) whether there is subordination to or preference over any indebtedness of the company; (3) the company's debt/equity ratio; (4) whether the alleged debt is convertible to stock; and (5) the relationship between holdings of stock in the corporation and holdings of the interest in question.[166] The Applicants' proposal provides for a note that appears to satisfy the first, second, fourth and fifth prongs. The note must be payable upon demand and at a fixed rate of interest once issued,[167] would not be convertible to equity and would be unsubordinated to other indebtedness of Genuity. In addition, there is no indication that the debt instrument would confer any of the benefits normally reflected in corporate ownership.[168] While satisfaction of the criteria, and in

[163] *See* AT&T May 5, 2000 Opposition at 10; Competition Policy Institute May 5, 2000 Comments at 5; NEXTLINK Feb. 16, 2000 Comments at 8, 9 (observing that the merged firm will not have to pay anything to convert the Class B shares).

[164] In *Richard R. Zaragoza*, for example, the Mass Media Bureau found that an up-front payment "does not change the fact that the option may not be exercised." *Richard R. Zaragoza*, File Nos. BRH-970207YA, BTCH-961029GI, Letter, 14 FCC Rcd 1732, 1737, para. 20 (MMB 1998) (rejecting arguments that a pre-paid option with only a nominal payment required for exercise should be treated as "perfected").

[165] AT&T May 5, 2000 Opposition at 23-24; Competition Policy Institute May 5, 2000 Comments at 6 (arguing that, under an earlier version of the proposal, the conversion right would vest once Bell Atlantic/GTE satisfies the 50-percent access line threshold).

[166] *See Fox II*, 11 FCC Rcd at 5720 , para. 16; *NextWave Personal Communications*, File Nos. 00341CWL96 *et al.*, Memorandum Opinion and Order, 12 FCC Rcd. 2030, 2049, para. 43 (1997) (*NextWave*).

[167] *See supra* n.96.

[168] *NextWave*, 12 FCC Rcd at 2057-58, para. 59.

particular the third factor, can be assessed conclusively only at such time as Genuity may choose to purchase the shares from the merged entity, we anticipate that Genuity would likely finance any note, or arrange to pay it off on an accelerated basis, by raising capital through such measures as a secondary offering. Under that circumstance, we would expect that the company's debt-equity ratio would be well within a range adequate to find that the note were debt. Consequently, if we were to apply these factors to the Applicants' potential debt instrument, we would likely find that the debt instrument would properly be considered bona fide debt. We expect the Applicants to inform the Commission if this contingency arises and to provide the Commission with any agreements between the Applicants and Genuity or the liquidating trustee.

65. We also disagree with opponents of the merger that the value the public places on the IPO shares should control our assessment of the likelihood of the contingency. Prior to any potential conversion, which may never occur, the merged entity is not entitled to 80 percent of the economic incidents of Genuity's operation, such as flowing through operating losses for tax purposes or obtaining dividends or other distributions beyond 10 percent.[169] Although AT&T and other merger opponents claim that, under an earlier version of the proposal, the post-IPO public shareholders will value their interest as approximately 20 percent of Genuity,[170] we find that the likelihood of the contingency depends upon Bell Atlantic's showing of compliance with the requirements of section 271 of the Act, matters within the Commission's expertise. Our assessment of the strength of a contingency predicated on section 271 compliance, therefore, may differ from the perception of market participants who value securities using forward-looking valuation methodologies, even if those approaches seek to weigh the likelihood that certain contingencies will take place. In addition, countering the emphasis that AT&T places on the market's perception of the value of the company is the actual accounting treatment of these assets – the Applicants have assured us that they will not be considered equity until converted.[171] Thus,

---

[169] The proposal therefore differs from the instruments at issue in *Fox I*, where the holders of the preferred stock, representing 76 percent of voting rights, were entitled only to a fixed return on capital investment, whereas all other profits and losses of the company, as well as the right to nearly all of the assets upon sale or dissolution, flowed to the holder of the common stock, which represented 24 percent of the voting rights. *Fox Television Stations, Inc.*, File No. BRCT-940201KZ, Memorandum Opinion and Order, 10 FCC Rcd 8452, 8457-58, para. 13 (1995) (*Fox I*).

[170] *See* ALTS May 5, 2000 Comments at 9; AT&T May 5, 2000 Opposition at 15-16, Ex. B (Declaration of Dr. Richard N. Clarke); AT&T Mar. 22, 2000 *Ex Parte* Letter at 1; Competition Policy Institute May 5, 2000 Comments at 4-5; ITAA May 5, 2000 Comments at 7 (arguing that financial markets would value the merged firm's interest in Genuity at approximately 80 percent).

[171] *See* Letter from Patricia E. Koch, Assistant Vice President Federal Regulatory, Bell Atlantic, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-184 (filed May 18, 2000) (Bell Atlantic/GTE May 18, 2000 *Ex Parte* Letter) (Declaration of Mark E. Gaumond); Letter from Steven G. Bradbury, Kirkland & Ellis, Counsel for GTE, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-184 (filed Apr. 14, 2000) (Declaration of Frederic V. Salerno) (explaining the merged firm's planned accounting treatment of Genuity). The parties initially disagreed over the treatment of contingent interests as a matter of accounting practices, with AT&T arguing that such interests would be treated as equity. The Applicants countered, however, with an affidavit from an accounting firm, that this transaction would not be treated as equity for accounting purposes. Bell Atlantic/GTE May 18, 2000 *Ex Parte* Letter (Declaration of Mark E. Gaumond). In response, AT&T argued in effect that such accounting treatment should be irrelevant to our consideration under section 3(1). Letter from Peter D. Keisler, Sidley & Austin, Counsel for AT&T, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-184 (filed May 30, 2000). *See also* Letter from Patricia E. Koch, Assistant Vice President Federal Regulatory, Bell Atlantic, to Magalie Roman Salas,
(continued....)

where the market may view the occurrence as not contingent, established accounting practices support that these assets should not be treated as equity prior to actual conversion.

(ii) The Purposes of Section 271

66. We find that Bell Atlantic/GTE's retention of a conditional interest in Genuity is consistent with and furthers the purposes underlying section 271, the particular statutory provision at issue in this case. In examining the effects of the conditional interest in light of the purposes of section 271, we believe it is relevant to consider whether the conditional interest is so significant that it would economically or otherwise disincentivize or divert resources from the carrier's obligations under the Act. Thus, in examining the status of a conditional interest under the 1996 Act, we are not concerned solely with the size of the investment but rather with the effect of the investment on the purposes of the particular statute at issue. As explained below, we find that the spin-off proposal will increase the merged firm's incentives to complete the section 271 process quickly so as not to lose the right to reacquire ownership and control of Genuity.

67. The Commission has often expressed section 271's dual underlying objectives. First, section 271 seeks to bring additional competition to the long distance market by offering the BOCs the potential opportunity to participate in that market.[172] Second, by conditioning BOC entry into the in-region, interLATA market on the BOC opening its local markets to competition, section 271 seeks to facilitate entry by new entrants into the BOC's local exchange market.[173] Together, these dual objectives further the overall purpose of the 1996 Act in facilitating competition in all telecommunications markets by fundamentally altering the incentives for market entry and by eliminating remaining monopoly bottlenecks.[174] Congress therefore used the promise of long distance entry as an incentive to prompt the BOCs to cooperate in facilitating competition in their local markets.[175]

(Continued from previous page)
Secretary, FCC, CC Docket No. 98-184 (filed June 1, 2000); Letter from Patricia E. Koch, Assistant Vice President Federal Regulatory, Bell Atlantic, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-184 (filed June 14, 2000) (illustrating the accounting treatment of Bell Atlantic/GTE's interest in Genuity). We therefore rely on the Applicants' assertions that the conditional interest will not be treated as equity for accounting purposes, and find that such treatment is consistent with our findings in this Order.

[172] *See, e.g., AT&T Corp. v. Ameritech*, File No. E-98-41, Memorandum Opinion and Order, 13 FCC Rcd 21438, at para. 36 (1998) (*Qwest Teaming Order*); *Ameritech Michigan Order*, 12 FCC Rcd at 20551-52, para. 15.

[173] *See, e.g., Qwest Teaming Order*, 13 FCC Rcd 21438, at para. 36; *Ameritech Michigan Order*, 12 FCC Rcd at 20553, para. 17.

[174] The purpose of the 1996 Act is to "provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition." Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996). *See also Ameritech Michigan Order*, 12 FCC Rcd at 20549-56, paras. 10-23 (describing the purposes of section 271).

[175] *See BellSouth Second Louisiana Order*, 13 FCC Rcd at 20602, para. 3; *Ameritech Michigan Order*, 12 FCC Rcd at 20551, para. 14.

68. We find that, rather than disincentivize the merged firm from opening its local markets, the spin-off proposal will provide Bell Atlantic with a substantial and compelling incentive to obtain section 271 authority quickly in order to reintegrate the operations of Genuity. Specifically, the spin-off proposal places Bell Atlantic under a time restriction requiring it to obtain section 271 authority representing 95 percent of its access lines within five years in order for the merged firm to acquire the right to convert the assets into a controlling interest.[176] Moreover, as discussed below, because the spin-off proposal requires the merged firm to ratably disgorge appreciation attributable to the period before it obtains section 271 approvals in the relevant states, Bell Atlantic/GTE has a substantial incentive to obtain section 271 authorizations as expeditiously as possible.[177] In addition, the risk that the merged firm will fail to obtain section 271 authority representing 50 percent of Bell Atlantic's access lines, and thereby lose its ability to recoup the value of the assets spun off to Genuity beyond a 10-percent interest, will provide a potent incentive for the merged firm to obtain section 271 authority quickly. In particular, because the spin-off involves all of the assets of Genuity, some of which are located outside of Bell Atlantic's region and could potentially be owned and operated by the merged firm lawfully, the shareholders of the combined firm bear the risk of losing the value of these out-of-region assets. This heavy shareholder burden should inspire Bell Atlantic/GTE's management to expend considerable resources in pursuit of demonstrating the openness of its local markets. Thus, the Applicants' proposal is designed to enhance Bell Atlantic's desire to satisfy the market-opening criteria established by Congress and thereby ensure that consumers will enjoy the long term benefits of competition among telecommunications providers.

69. We also reject arguments by merger opponents that the spin-off proposal enables Bell Atlantic/GTE to gain impermissibly the appreciation of a prohibited entity or realize substantial material benefits prior to attaining section 271 authorization. Rather, we find that, by requiring the merged firm to ratably disgorge appreciation attributable to the period before it obtains section 271 approval in the relevant states, the proposal gives the merged firm an added incentive to obtain section 271 authorizations as quickly as possible. In particular, AT&T and others criticized an earlier version of the Applicants' proposal that would have allowed the merged entity, if and when it obtained the requisite approval under section 271, to convert its interests into shares of Genuity that would fully capture any prior appreciation in the value of Genuity shares, including appreciation attributable to Genuity's interLATA activities in states in which the merged entity did not at the time have section 271 approval.[178] These opponents

---

[176] We note that under the Applicants' proposal, the Commission has discretion to grant an extra year in the event that the merged firm obtains 90 percent (or 95 percent but-for one state) of the requisite section 271 approvals.

[177] The requirement that Bell Atlantic/GTE ratably disgorge appreciation that is attributable to the period in time before section 271 authorization also undercuts AT&T's argument that the merged firm will obtain material benefits uniquely associated with the long distance market prior to the time that it is authorized to provide those services. *See* AT&T May 5, 2000 Opposition at 5. *See also Qwest Teaming Order*, 13 FCC Rcd 21438, at para. 37.

[178] *See* AT&T May 5, 2000 Opposition at 4-5 (contending that section 271 prohibits a BOC from obtaining greater-than-10 percent equity returns from the long distance market from the period before the effective date of the grant); ITAA May 5, 2000 Comments at 1-2, 6-7 (alleging that Bell Atlantic/GTE would impermissibly obtain the benefit of Genuity's appreciation). *See also* Letter from Jonathan Jacob Nadler, Squire Sanders & Dempsey L.L.P., (continued....)

argued that the potential retroactively to capture appreciation attributable to what were at the time prohibited services was evidence of "ownership" and diminished the incentive to comply with section 271 prior to the five-year deadline. The Applicants revised the proposal to address this concern by excluding from the benefits captured by Genuity upon conversion the amount of appreciation roughly proportional to revenues from areas in which section 271 approval had not yet been obtained. Thus, rather than having an incentive to delay section 271 approval, the merged entity will have an incentive to obtain approval as quickly as possible so that it may fully participate in any appreciation in the value of its potential interest.

(iii) Likelihood of Discrimination

70. We recognize that, through its ownership of the Class B shares, the merged firm has an incentive to enhance the value of Genuity's stock. Although Bell Atlantic/GTE's retention of a conditional interest will increase its incentive to engage in discriminatory behavior,[179] any such behavior on the merged entity's part would be readily detectable. We find that the significant risk of detection of any discriminatory conduct on Bell Atlantic/GTE's part should serve to restrain the company from acting on any incentive to discriminate in favor of Genuity.

71. Although we have no doubt that incumbent local exchange carriers would be able to use their bottleneck local exchange facilities to discriminate in the provision of Internet and data services, for the reasons set forth below, we find that any attempt by the merged entity to discriminate in such a manner would be readily detectable. At the same time, however, we note the weakness of the argument by opponents of the merger that the Applicants would be able to discriminate in favor of Genuity. AT&T, for example, provides only a limited discussion in support of its contention that the merged entity can plainly "discriminate."[180] Although AT&T notes Bell Atlantic's "continued control of bottleneck local exchange facilities," the Applicants respond, without contradiction, that Genuity does not currently "rely to any significant degree on Bell Atlantic's core LEC facilities" – Applicants' euphemism for bottleneck facilities – "to provide Internet and data services."[181] Second, AT&T argues that the merged firm could discriminate in favor of ISPs that resell Bell Atlantic's DSL service by providing superior quality of transport service to their internet backbone provider.[182] However, the Applicants respond, again without contradiction, that "traffic from Bell Atlantic's DSLAMs is not directly connected to any Internet backbone provider," but instead is aggregated and delivered to the ISP premises,

(Continued from previous page)
Counsel for Information Technology Association of America, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-184 (filed June 1, 2000) (ITAA June 1, 2000 *Ex Parte* Letter), Att. at 3.

179 We note that because section 3(1) allows for a BOC to hold a 10-percent equity interest in a prohibited entity, some effect on a BOC's incentives is implicitly allowed under the statute.

180 AT&T Feb. 15, 2000 Opposition at 29.

181 Bell Atlantic/GTE Feb. 22, 2000 Reply at 28.

182 AT&T Feb. 15, 2000 Opposition at 30. Specifically, AT&T alleges that the merged entity could provide better "throughput" to Genuity, meaning that it would transmit packets more quickly for Genuity than for its competitors.

where the ISP controls the link to the Internet backbone provider.[183] In any event, however, we conclude for the reasons stated below that the merged entity will be unlikely to discriminate because of the likelihood that any such discrimination would be detected and appropriate enforcement action would be taken.

72. Specifically, to the extent that Genuity purchases access services, tariffed or otherwise, from the merged entity, we require the merged entity to report, on a disaggregated, company-specific basis,[184] certain measurements, all but one of which it currently provides as part of the Commission's ARMIS requirements.[185] With respect to its provision of high-speed special access and regular special access services, we require Bell Atlantic/GTE, or any applicable affiliate,[186] to report: the percent of commitments met; the average interval (in days); the average delay days due to lack of facilities;[187] the average interval to repair service (in hours) and the trouble report rate.[188] These measurements should be reported on a monthly basis and made available to the independent auditor.[189] Thus, if, as ITAA suggests, the merged entity were to attempt to discriminate by favoring Genuity in the provision of high capacity special access circuits,[190] we find that this would be detectable by the independent auditor and this Commission.

73. Moreover, if, as ITAA also suggests, the merged entity were to attempt to discriminate in favor of Genuity by providing it "preferential access" to conditioned copper loops used to provide advanced services,[191] we find that this behavior would be readily detectable as well. Specifically, to the extent that Genuity purchases loops from the merged entity as unbundled network elements pursuant to section 251, we find that any discrimination in the

[183] Bell Atlantic/GTE Feb. 22, 2000 Reply Tab B at 2 (Affidavit of Raymond F. Albers).

[184] The merged entity, therefore, will report on its provision of these services to all companies, including Internet service providers, Internet backbone providers and interexchange carriers.

[185] *See* 47 C.F.R. § 43.21(g); ARMIS 43-05 Service Quality Report, Table 1 (establishing reporting requirements for special access provided to interexchange carriers).

[186] For example, these reporting requirements attach to the separate advanced services affiliate if it begins to provision these special access circuits to Genuity.

[187] We note that average delay days due to lack of facilities is not currently reported through ARMIS. This measurement tracks average calendar days from due date to completion date on company missed orders due to lack of facilities.

[188] *See infra* Appendix D (Conditions) at para. 53. As provided in the Conditions, Bell Atlantic/GTE shall, in consultation with the Chief of the Common Carrier Bureau, modify these measurements and develop any applicable performance measurement business rules to the extent necessary. Any developed business rules, once approved by the Chief of the Common Carrier Bureau, will be made publicly available.

[189] *See infra* Appendix D (Conditions) at para. 56(f).

[190] *See* ITAA June 1, 2000 *Ex Parte* Letter Att. at 3 (alleging that the merged firm could discriminate in favor of Genuity in the provision of high-capacity point-to-point local circuits).

[191] *See id.* (alleging that the merged firm could provide preferential access to copper loops used in the provision of xDSL service).

provisioning of such loops would become apparent in the section 271 approval process. In this respect, we note that Bell Atlantic/GTE must obtain section 271 approval with respect to 50 percent of its access lines to avoid a major loss. In addition, it cannot convert its interest in Genuity until it receives approval with respect to 95 percent of its access lines, and will lose part of any appreciation of Genuity on account of any delay in obtaining section 271 approval. In order to obtain section 271 approval, of course, Bell Atlantic/GTE must show that it provides nondiscriminatory access to its bottleneck facilities.[192] In these circumstances, any attempt to use its bottleneck facilities to discriminate would jeopardize the merged firm's ability to reacquire ownership and control of Genuity[193] or, at the least, subject it to losses due to delay in obtaining section 271 approvals.

74. We find that the requirements that we adopt today with respect to providing disaggregated data on the merged entity's provision of special access circuits and the showing of nondiscriminatory access to unbundled loops required for the merged firm to demonstrate section 271 checklist compliance, will make any attempted discrimination in favor of Genuity in the provision of these services highly detectable. To the extent that parties allege that the merged firm could use its control over bottleneck assets to the detriment of Genuity's competitors in other ways,[194] such behavior may be readily apparent to the independent auditor, and, in any event, parties are always free to file section 208 formal complaints alleging a violation of the nondiscrimination provisions of the Act.[195] Thus, we conclude that the detectability of anticompetitive behavior, combined with the merged firm's incentive to obtain section 271 authority, will provide a potent deterrent to restrain the merged firm from acting on any incentive to impede competition through the use of Bell Atlantic's bottleneck facilities. Accordingly, we find that the ease in detecting discrimination on the merged firm's part in favor of Genuity serves to decrease the likelihood that such discrimination will in fact occur.

75. We note that this conclusion is similar to Judge Greene's findings in *Tel-Optik*. In that case, Judge Greene recognized the possibility that an acquisition of a conditional interest could provide a BOC with "substantial incentive and ability unfairly to impede competition by use of its monopoly position in the market it is thus entering."[196] He concluded, however, that if

---

[192] For subsequent section 271 applications, we expect that Bell Atlantic/GTE will submit disaggregated data showing its performance in processing orders and provisioning unbundled loops to Genuity as compared with its performance with respect to other carriers.

[193] We note that competitors have vigorously pursued allegations of discriminatory conduct in prior section 271 applications, and we have no reason to suspect that such vigor will diminish in the future.

[194] *See* ITAA June 1, 2000 *Ex Parte* Letter Att. at 3 (asserting that the merged firm could "steer" its large business customers to Genuity, and otherwise provide service "on favorable terms" to customers of its dial-up Internet access service that select Genuity as their Global Service Provider or to its unaffiliated ISP customers that hand-off traffic to Genuity).

[195] 47 U.S.C. § 208.

[196] Judge Greene recognized that, even if the BOC would have an ability to discriminate, this ability "will not render the conditional interest infirm if the incentive to act anticompetitively is absent." *Tel-Optik*, 1986 WL 11238 at *3. Despite the "obvious economic incentive" of the BOC in that case to enhance the value of the target (continued....)

the BOC would attempt to use its monopoly position to disadvantage competitors, "that attempt would almost certainly be made known to the Court during any subsequent waiver proceedings." Similarly, in the instant case, the knowledge that discrimination would be detected either by the independent auditor or in subsequent section 271 proceedings, and possibly deprive the BOC of its ability to exercise the conversion right, reduces the likelihood that the merged entity will engage in such behavior.

3. Control

76. As set forth below, we conclude that Bell Atlantic/GTE will not control Genuity.[197] We find that, under the Applicants' proposal, Bell Atlantic/GTE will not exercise *de jure* or *de facto* control of Genuity prior to the potential conversion of its Class B shares. As an initial matter, we find no evidence that, prior to any potential conversion, Bell Atlantic/GTE will have *de jure* control, or voting control, of Genuity.[198] We recognize that *de facto* control, or actual control of a company, presents a closer question. As discussed below, having examined the composition of the board and management, the minority shareholder protections, Genuity's financing arrangements, the contractual relationship between the entities following the spin-off, and other factors, we find that the merged firm will not have the power to dominate Genuity's corporate affairs and, therefore, is not in actual control of Genuity. We note, however, that we base our conclusion on representations made by the Applicants regarding the relationship between the merged firm and Genuity after the spin-off. Should the actual relationship between Bell Atlantic/GTE and Genuity deviate from or extend beyond those representations, the Commission would be compelled to reevaluate its assessment of whether the merged firm controls Genuity. In the event that the Commission finds that, in light of the changed circumstances, the merged firm does, indeed, control Genuity, we will take appropriate enforcement action which may include issuing a standstill order.[199]

77. The determination as to whether an entity is in *de facto*, or actual, control of another entity "transcends formulas, for it involves an issue of fact which must be resolved by the special circumstances presented."[200] Because the inquiry is inherently factual and not subject

(Continued from previous page)
company's stock and the success of its operations, the line-of-business waiver process deterred the BOC from engaging in anticompetitive conduct. *Id.*

[197] 47 U.S.C. § 153(1).

[198] In this case, the merged entity has voting rights of only 9.5 percent, which we find insufficient to evidence *de jure* control. *See, e.g., Lockheed Martin Corp.*, Memorandum, Order and Authorization, FCC 99-237, at para. 30 (rel. Sept. 15, 1999); *Fox I*, 10 FCC Rcd at 8513, para. 151 (noting that *de jure* control is typically evidenced by ownership of more than 50 percent of an entity's voting interests).

[199] *See, e.g., AT&T Corp. v. Ameritech Corp.*, File No. E-98-41, Memorandum Opinion and Order, 13 FCC Rcd 14508 (1998).

[200] *Stereo Broadcasters, Inc.*, 55 FCC2d 819, 821 (1975). *See also Applications of Roy M. Speer and Silver Management Company*, File Nos. BTCCT-950913KG *et al.*, Memorandum Opinion and Order, 11 FCC Rcd 14147, 14157, para. 24 (1996) (*Roy M. Speer*) (stating that the determination of locus of control and influence necessarily depends upon the facts surrounding each case and the parties or persons involved).

to a precise formula, we must look at all relevant factors and the totality of the circumstances.[201] In ascertaining where actual control resides, "we are governed chiefly by the demonstration of [the shareholder's] power to dominate the management of corporate affairs."[202] Although the percentage of voting stock held by a minority shareholder is relevant, the Commission also has considered as important factors the right to elect members of the company's board of directors, to determine the manner of operation, to make strategic decisions, and to control personnel and financing decisions.[203] The Commission has recognized that spin-off situations may warrant greater flexibility in applying these factors.[204]

78. Having reviewed these and other factors, both individually and cumulatively, below, we are persuaded that Bell Atlantic/GTE would not exercise *de facto* control of Genuity. Prior to any potential conversion of the Class B shares, the public shareholders will have 90 percent of the voting rights, will elect twelve of the thirteen directors, and will have a potential right to acquire Bell Atlantic/GTE's shares if the contingency is not satisfied. Nothing on the record undermines the public shareholders' ability to manage and operate Genuity through this substantial voting control and board participation. Consequently, as described below, the merged firm will not be in a position to dominate the management of Genuity, or control its business decisions, personnel practices or finances. Although we do not dispute that the merged firm may

[201] *See Lockheed Martin Corp.*, at para. 30 ("Under Commission precedent, a *de facto* control determination involves the balancing of facts and is based on the 'totality of the circumstances.'").

[202] *Univision Holdings, Inc.*, File Nos. BTCCT-920508KG-KL *et al.*, Memorandum Opinion and Order, 7 FCC Rcd 6672, at para. 15 (1992) (*quoting Benjamin L. Dubb*, 16 F.C.C. 274, 289 (1951)). *See also Fox I*, 10 FCC Rcd at 8414-15, paras. 154, 156.

[203] *See, e.g., id.*; *Airgate Wireless, L.L.C.*, File No. 0000002035, Memorandum Opinion and Order, 14 FCC Rcd 11827, 11840, para. 26 (1999); *Fox I*, 10 FCC Rcd at 8515, para. 156; *Metromedia Inc.*, Memorandum Opinion and Order, 98 F.C.C.2d 300 (1984) (indicating that that the touchstone of control is the ability to determine a company's policies and conduct its affairs). In broadcast cases, for example, the Commission traditionally has relied upon six factors, established in *Intermountain Microwave*, to ascertain the locus of control: (1) who determines and carries out the policy decisions; (2) who is in charge of the payment of financing obligations, including operating expenses; (3) who controls daily operations; (4) who is in charge of employment, supervision, and dismissal of personnel; (5) does the licensee have unfettered use of all facilities and equipment; and (6) who receives the monies and profits from the operation of the facilities. *See Intermountain Microwave*, Order, 24 Rad. Reg. (P&F) 983, 984 (1963); *Airgate*, 14 FCC Rcd at 11840, para. 26.

[204] For example, in *WWOR-TC, Inc.*, the Commission reviewed two prior spin-off situations and concluded that:

> these cases can be said to stand for two propositions. First, when a company is spun off, Commission requirements can still be met upon a review of all relevant facts, despite "carryover" employees, common directors and even on-going business relationships. Second, petitioners that wish to challenge such spin-offs as inconsistent with our requirements must allege specific facts to establish a substantial and material question as to whether the required degree of segregation would not be established or that the parties would not reasonably be expected to conduct themselves as represented.

WWOR-TC, Inc., BTCTT-901127KE, Memorandum Opinion and Order, 6 FCC Rcd 193, 201, para. 16 (1990).

have limited influence over Genuity, we find that this limited influence will not exceed the degree permitted by section 3(1).

79. *Voting Control.* While control over an entity confers affiliate status under section 3(1), the structure of the statute implies that a limited degree of influence, short of control, is permissible. This conclusion follows implicitly from section 3(1)'s recognition that a BOC may hold up to ten percent of the stock in a prohibited entity.[205] Our concern in section 3(1), therefore, must be whether the entity holds *de facto* control, or exercises influence beyond the implicit *de minimis* level permitted by the statute. Thus, the mere fact that Bell Atlantic/GTE will be a 9.5-percent voting shareholder of Genuity, a widely held, publicly traded company, is not dispositive of the locus of control. In fact, we note that under the proposal other entities may exercise voting control twice that of Bell Atlantic/GTE.[206]

80. *Investor Safeguards.* We find that the minority investor protections afforded to the Class B shareholder or Bell Atlantic/GTE, as the case may be, are narrowly tailored and do not rise to a level that would consistently inject the merged firm into Genuity's business and policy decisions.[207] Commission precedent recognizes that non-controlling shareholders have an incentive to act to protect their investment and may influence the operation of a company.[208] Accordingly, the Commission has permitted minority shareholders "to wield significant influence, including the ability to affect the outcome of votes or the day-to-day operations of a company, so long as that influence does not rise to a consistent level of dominance at which the minority shareholder is determining how the company runs and what business choices it makes."[209] Minority investor protections, for example, are commonly used to induce investment and ensure that the basic interests of minority stockholders are protected.[210] Accordingly, the Commission has stated that "the right to vote on matters involving extraordinary corporate

---

[205] *See WWOR-TV*, 6 FCC Rcd at 199, para. 13 (indicating that a limited degree of influence of domestic broadcast stations is implicit in section 310(b), which permits foreigners to hold up to 25 percent of the stock of the parent of a licensee and to hold up to 25 percent of the seats on its board).

[206] Although Bell Atlantic/GTE's maximum voting percentage is limited to 9.5 percent, which will be diluted if Genuity issues additional shares, other entities may vote up to 20 percent of Genuity's shares at any time. Given the merged firm's limited right to vote and the other circumstances of the spin-off proposal, we reject arguments that the 20-percent voting restriction evidences control. *See* Competition Policy Institute May 5, 2000 Comments at 8-9; CompTel Feb. 15, 2000 Comments at 4-5.

[207] *See* Competition Policy Institute May 5, 2000 Comments at 8; CompTel Feb. 15, 2000 Comments at 5-6; NEXTLINK Feb. 16, 2000 Comments at 10-11 (contending that the investor safeguards, which were subsequently narrowed, restricted the public shareholders' discretion in making business decisions).

[208] *See, e.g., Lockheed Martin Corp.*, at para. 31; *NextWave*, 12 FCC Rcd at 2042-43, para. 30 (explaining that minority or non-voting shareholders may be given a decision-making role in major corporate decisions that fundamentally affect their interests as shareholders, such as issuance of stock, expenditures that significantly affect market capitalization, incurrence of significant debt, sale of major corporate assets, and fundamental changes in corporate structure, without being deemed to be in *de facto* control).

[209] *See Lockheed Martin Corp.*, at para. 31.

[210] *See id.*, at para. 39.

actions does not ordinarily undermine the nonattributable character of otherwise non-cognizable interests, so long as that right is narrowly circumscribed."[211]

81. We find that the minority investor protections accorded to the Class B shareholders or Bell Atlantic/GTE are narrowly tailored to protect the company's initial equity investment and its potential right to convert the Class B shares upon satisfaction of the conditions.[212] By leaving room for Genuity's management to, for example, enter into acquisitions of up to 20 percent of Genuity's fair market value without Bell Atlantic/GTE's consent, the safeguards do not enmesh the merged firm in all major decisions regarding how the company runs it operations or what business choices it makes. Moreover, through its veto rights, the merged firm cannot compel Genuity's officers and directors to pursue any particular course of action. Instead, the merged firm can only block, by withholding its consent, certain actions contemplated by Genuity's management.

82. *Officers and Directors*. We find that the selection and composition of Genuity's officers and directors do not evidence control of Genuity by the merged firm. In particular, we note that the board structure is designed to minimize concern that GTE's initial selection of board members will result in Bell Atlantic/GTE controlling Genuity or its board. As with other spin-off situations, the initial board of Genuity has been selected by GTE, its former parent. In this case, however, potential concern over board independence stemming from GTE's initial selection is tempered by the fact that shortly after the IPO a majority of the directors will be individuals who were not selected by GTE and who have no prior affiliation with either Bell Atlantic or GTE.[213] Specifically, within 90 days of the IPO, the four initial independent directors

---

[211] *See BBC License Subsidiary L.P. and SF Green Bay License Subsidiary, Inc.*, File Nos. BALCT-941014LH, BALTT-941014LI, Memorandum Opinion and Order, 10 FCC Rcd 7926, 7933, para. 41 (1995) (*BBC License Order*). *See also Applications of Quincy D. Jones and Qwest Broadcasting L.L.C.*, File No. BTCCT-941214KG, Memorandum Opinion and Order, 11 FCC Rcd. 2481, 2487, para. 29 (1995) (clarifying that, whether the right arises "in the form of an investor voting right derived from its equity interest or in the form of a licensee obligation derived from its debtor status," the right to participate in extraordinary corporate actions is ordinarily non-attributable so long as narrowly circumscribed); *Roy M. Speer*, 11 FCC Rcd at 14158, para. 25 (finding that rights accorded to a nonvoting stockholder to approve certain fundamental matters were "permissible investor protections that neither substantially restrict [the voting entity's] discretion nor rise to the level of attributable influence.").

[212] In *Roy M. Speer*, for example, unanimous approval of both the entity with voting control and the non-voting stockholder were required for certain fundamental matters that included: (1) any transaction not in the ordinary course of business; (2) the acquisition or disposition of any assets or business with a value of 10 percent or more of the company's market value; (3) the incurrence of any indebtedness with a value of 10 percent or more of the company's market value; (4) any material amendments to the certificate of incorporation or bylaws; (5) engaging in any line of business other than media, communications and entertainment; (6) the settlement of any litigation, arbitration or other proceeding other than in the ordinary course of business; and (7) any transaction between the company and the entity with voting control, other than those of a certain size or on an arm's length basis. *Roy M. Speer*, 11 FCC Rcd at 14155, para. 18. *See also Lockheed Martin Corp.*, at n.90 (describing restrictions on Comsat's ability to engage in certain business activities without the consent of Lockheed Martin), at n.92 (describing standard minority protections approved by the Commission).

[213] *See WWOR-TV*, 6 FCC Rcd at 202 n. 19 (expressing no concern with a foreign-controlled entity's role in nominating the proposed board because, as a practical matter, the company was spun off as a means to eliminate the alien ownership problem); *id.* at 201-02, para. 18 (finding that control of the board would be in the hands of those (continued....)

selected by GTE will select seven other independent directors. As a further safeguard against any potential lack of independence, rather than being locked in for specific multi-year terms, twelve directors (the four selected by GTE plus the additional independent directors selected by those four, as well as the Genuity CEO) will stand for election by the public shareholders within 9 months of the IPO. The potential for board turnover substantially mitigates potential concern over the independence of the initial board members.

83. Although we note that the Class B shareholder has the right to designate one board member (who will refrain from voting until the board comprises at least 10 members), we do not find that such designation grants the Class B shareholder control over Genuity or its board.[214] There will be a clear majority of board members with no interest in Bell Atlantic/GTE, and no past association with either company. All of the directors, including the Class B designee, should have every incentive, as well as a clear fiduciary duty, to serve only the best interests of Genuity, regardless of whether this is also in the best interests of the merged firm.[215] We note that the proposal gives the directors the power and opportunity to carry out their fiduciary duties. Thus, we find nothing on the record to doubt that the directors will act in strict accordance with their clear fiduciary responsibility.[216] This expectation similarly applies to those officers and managers of Genuity who were previously employed by one of the merging parties.[217]

84. We have carefully examined the impact of any prior relationship with the merging parties upon the ability of Genuity's officers and directors to control major business and policy decisions of the company.[218] Because Genuity is being spun off from GTE, a number of initial

(Continued from previous page)
who had not been officers, directors or employees of the foreign-controlled entity, and that after the proposed tender offer, six of the eight directors would have no connection to that entity). *See also Iacopi v. FCC*, 451 F.2d 1142, 1148 (9th Cir. 1971) (noting that after the spin-off of Viacom from CBS to comply with Commission rules, of the nine Viacom directors, six had not previously been directors, officers or employees of CBS while three others were former employees).

[214] *See, e.g., GWI PCS, Inc.*, 12 FCC Rcd at 6455, para. 34 (finding entity did not have *de facto* control despite its ability to elect two of 13 members of the board of directors); WWOR-*TV, Inc.*, BTCCT-901127KE, Memorandum Opinion and Order, 6 FCC Rcd. 6569, 6582, para. 14 (1991) (finding, for purposes of section 310(b)(4)'s 25-percent foreign ownership restriction, that even assuming that the two directors who were senior officials at the foreign-controlled organization were representatives of the foreign entity, no violation would exist because they represented only 25 percent of the Board).

[215] *See Columbia Pictures Industries, Inc.*, 30 FCC2d at 16; *WWOR-TV*, 6 FCC Rcd at 201-02, para. 18.

[216] *See Lockheed Martin Corp.*, at para. 37 (declining to speculate that directors would breach their fiduciary obligations "in the absence of sufficient particularized facts to overcome the presumption that all of the directors will fulfill their fiduciary obligations within an active and independent board of directors").

[217] *See WWOR-TV*, 6 FCC Rcd at 200, para. 14 (noting that in the CBS/Viacom spin-off, "[m]ost of Viacom's officers and employees would perform the same roles they had performed for CBS").

[218] *See Airgate*, 14 FCC Rcd at 11841, para. 27 (rejecting certain arrangements between a spunoff company and its former parent, including that the spunoff company was prohibited from deploying or investing in other technologies, and that the former parent company enjoyed a right to review bids submitted by other equipment vendors prior to submitting its own bid).

decisions affecting Genuity were made by GTE prior to the spin-off. We find, however, that these decisions do not lock in Genuity's officers and directors to specified courses of action, but rather are of a transitional nature and allow for the officers and directors to make independent business decisions on a going-forward basis. We note that several members of Genuity's management worked for Genuity's precursor, BBN, prior to its acquisition in 1997 by GTE, and thus have experience with independently managing and growing an Internet backbone company.

85. Given the contingent nature of the conversion right, we also find that, to the extent the existence of the Class B conversion right carries any degree of control in the eyes of Genuity's officers and directors,[219] any such control premium will be negligible.[220] Genuity's management undoubtedly will be cognizant of the conditional conversion right that carries with it a possibility that Bell Atlantic/GTE will obtain control of the company at some point in the future. Nonetheless, the merged firm will not have an absolute legal right to reacquire Genuity. Genuity's officers and directors therefore cannot be certain that the merged firm will satisfy the access line thresholds. Moreover, in the event that Bell Atlantic/GTE fails to meet the 95-percent threshold, the public shareholders will have the right to purchase its shares in return for a debt instrument. Thus, although the officers and directors will be aware of the possibility that Bell Atlantic/GTE will reacquire the company, they also will recognize that the Class A shareholders may ultimately retain full ownership of the company. This countervailing consideration weighs against ascribing an influential degree of control to the mere existence of Bell Atlantic/GTE's conditional conversion right.[221]

86. *Finances*. We find that Bell Atlantic/GTE will not have control of Genuity's finances. At the time of the spin-off, the proceeds of the IPO will represent the primary source of financing for Genuity, and the spun-off entity will not be obligated to Bell Atlantic/GTE on any loan. Genuity retains the right to seek additional funding through arm's-length loans from the merged firm, but is not obligated to do so. If it does obtain loans from Bell Atlantic/GTE, these cannot amount to more that 25 percent of the total outstanding debt of Genuity. Because Genuity is under no obligation to obtain funding from the merged firm, and Bell Atlantic/GTE's ability to loan money to Genuity is restricted in any event, we conclude that any potential financing arrangements with the merged firm will not vest control of Genuity's finances in Bell Atlantic/GTE. Indeed, as a public corporation, Genuity has the ability to issue additional shares to finance some of its operational needs. In addition to examining the source of the funds, we also assess whether the locus of Genuity's financing decisions remains with Genuity, and find that it does. Although under the investor safeguards the merged firm's consent is required for Genuity to issue debt in excess of $11 billion, we are persuaded that the size of this restriction

[219] *See* ALTS May 5, 2000 Comments at 4; AT&T May 5, 2000 Opposition at 6, 27; AT&T Mar. 22, 2000 *Ex Parte* Letter at 4, 19; Competition Policy Institute May 5, 2000 Comments at 7; Telecommunications Resellers Assoc. Feb 15, 2000 Comments at 12-13.

[220] *See NextWave*, 12 FCC Rcd at 2038-39, para. 21 (finding that "the fact that some of NextWave's management have been associated with Qualcomm does not support a finding of affiliation.").

[221] *See Lockheed Martin Corp.*, at para. 40 (finding that the existence of second stage of merger agreements was not sufficiently influential to constitute an element of actual control).

leaves sufficient room for Genuity to control major decisions regarding financing. Thus, we find that the potential right to obtain arm's-length loans from the merged entity and the limited role of the merged firm in approving debt beyond $11 billion do not vest control of Genuity's finances in Bell Atlantic/GTE.

87. *Commercial Contracts.* We find that the contractual relationship between Bell Atlantic/GTE and Genuity following the spin-off will not result in transferring day-to-day operational control of Genuity to Bell Atlantic/GTE. By their nature, the administrative support services contracts are transitional, limited to not more than one year, and expressly terminable by Genuity without penalty at any time.[222] We note also that the services provided by the former parent do not appear to involve the merged firm in Genuity's core operations. Many of the support services that are included in the contracts appear to be functions that are commonly outsourced, such as billing, payroll services, benefits administration and processing, cash processing, realty and leasing management, environmental and safety services and information technology services.[223] The merged firm will not, for example, have any role in hiring or firing Genuity employees, in training employees, in strategic planning and business development, in legal counsel and regulatory affairs support, and in advertising and other corporate communications.[224] We therefore find it reasonable in this case that the merged entity may continue to provide narrowly-defined support services for a limited transitional period following the spin-off. Given the transitional nature of these narrowly-defined support services, which will not entail Genuity's core operations, we also conclude that Bell Atlantic/GTE will not be "providing" in-region, interLATA services in violation of section 271 through these contractual relationships.[225]

88. We further find that the joint marketing agreement between the merged firm and Genuity does not confer control over Genuity. Although the Purchase, Resale and Marketing Agreement has a five-year term and obligates Genuity to provide most favored customer pricing to Bell Atlantic/GTE, the Agreement is not exclusive and does not apply to those states in which the combined entity is prohibited from providing in-region, interLATA services. Genuity therefore has the right to market, distribute and sell its services nationwide, either directly or indirectly through other dealers or distributors, and according to the prices and volume or other

---

[222] *See WWOR-TV,* 6 FCC Rcd at 203-04, paras. 20-21 (allowing transitional arm's-length administrative arrangements in a spin-off situation, including a program supplier contract, a trademark license agreement, leases of office space, and a limited interim services agreement, to avoid the highly-disruptive immediate severance of such relationships); *Airgate*, 14 FCC Rcd at 11842, para. 29 (finding no evidence that a former parent controlled a spunoff entity because it offered to provide accounting, financial management, tax, payroll, shareholder and public relations, legal, human resources, procurement, real estate management, and other administrative services to the spunoff entity).

[223] Bell Atlantic/GTE June 7, 2000 Glover *Ex Parte* Letter Att. 1.

[224] In view of the limited scope of the transitional and other contracts between the companies, we reject Covad's assertion that, under an earlier version of the contracts, there is little left for Genuity, "a shell of a corporation," to do. *See* Covad May 5, 2000 Comments at 7. *See also* Cable & Wireless Feb. 22, 2000 Reply at 4-5.

[225] *See* Covad May 5, 2000 Comments at 11.

purchase discount arrangements that it desires to make available to its other customers. In addition, we find that the agreement specifies that the prices for certain Genuity services will be renegotiated annually, or even quarterly. Moreover, because the contract specifies that the merged firm will not provide or jointly market in any state for which it has not obtained section 271 authority any Genuity service that is, or includes as a bundled component, an interLATA service, we also conclude that Bell Atlantic/GTE will not be "providing" in-region, interLATA services in violation of section 271 through the joint marketing agreement between the companies following the spinoff.[226]

89. *EDP Distinctions*. AT&T further suggests that various attribution rules under our *Cable Attribution Order* and *Broadcast Attribution Order* are pertinent to the control analysis and support a finding that Genuity would be an affiliate of the merged entities.[227] We disagree. Both the broadcast equity-debt plus (EDP) attribution rule and the cable equity plus debt rule provide, in specific circumstances, for attribution of certain financial investments (including options and warrants) when the investor holds an interest in excess of 33 percent of the total asset value of the entity.[228] These rules focus directly on those financial relationships in which there is significant incentive and ability for the otherwise nonattributable interest holder to exert influence over the core operations of the licensee. As we explained in the *Broadcast Attribution Order*, "[t]he approach of focusing on specific triggering relationships would extend the Commission's current recognition that the category or nature of the interest holder is important to whether an interest should be attributed."[229] A similar equity-debt rule arises under our *Cable Attribution Order*. We stated in that Order that, in adopting the ED rule, "[w]e affirm our conclusion in the *Broadcast Attribution Order* that there is the potential for certain substantial investors or creditors to exert significant influence over key decisions, which may undermine the diversity of voices we seek to promote."[230] Therefore, reflecting our view that relationships that offer potential for significant influence or control should be counted in applying the broadcast and cable ownership rules, which promote diversity and competition, we adopted a targeted prophylactic, structural rule under which we would make certain interests attributable using a bright line test.

---

[226] *See Qwest Teaming Order*, 13 FCC Rcd at 21438. In this regard, the contractual relationship between the merged firm and Genuity created through the joint marketing and transitional support services contracts is manifestly different from Ameritech's and US WEST's arrangements with Qwest that were found to violate section 271 in the *Qwest Teaming Order*. *See Qwest Teaming Order*, 13 FCC Rcd at 21438.

[227] AT&T Mar. 22, 2000 *Ex Parte* at 2-3 (*citing Implementation of the Cable Television Consumer Protection and Competition Act of 1992*, CS Docket No. 98-82, Report and Order, FCC 99-288 (rel. Oct. 20, 1999) (*Cable Attribution Order*); and *Review of the Commission's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, Report and Order, 14 FCC Rcd. 12559, 12582, para. 47 (1999) (*Broadcast Attribution Order*)).

[228] *See* 47 C.F.R. § 73.3555 Note 2(j); 47 C.F.R. § 76.503 Note 2(i).

[229] *Broadcast Attribution Order* at para. 47. Attribution is triggered under the broadcasting debt-equity-plus rule only when the requisite financial interest is coupled with one of two triggering relationships (major program supplier or same market media entity).

[230] *Cable Attribution Order* at para. 83.

90. That same range of concerns is absent here, where we are primarily focused upon the competitive considerations underlying section 271, a provision that entails case-specific inquiry. Accordingly, we decline to adopt in this proceeding any bright line test for assessing whether an entity is an affiliate within the meaning of section 3(1). Instead, in this instance, we employ a case-specific evaluation tailored to the circumstances now before us, which implicate section 271. Thus, unlike the cable and broadcasting contexts, the specific policy concerns present here persuade us that a case-specific evaluation will best effectuate the applicable statutory purposes.

91. Finally, a third application of the equity-debt rule arises under section 623 of the Act, for which we have developed the LEC effective competition test. Under that test, effective competition exists (sufficient to free rates of a cable operator from regulation) where a LEC or its "affiliate" provides video programming services comparable to those of an unaffiliated cable operator. In determining affiliation for these purposes, the Commission has used the ED rule: "We believe that an ED investment, given its size, by a LEC gives an MVPD significant access to the resources of a LEC such that it can be presumed that there is effective LEC competition [with the cable operator]."[231] The question here, however, was not whether or not the LEC would have "control" over the related entity. Instead, our focus was different – whether the related entity would have sufficient support from the LEC and access to its resources, so that it could effectively compete with the unaffiliated cable operator. That is a concern very specific to section 623 of the Act. As a result, the policy concerns driving that bright line test are inapplicable here.

4. Other Issues

a. Transfer of GTE Telecom Wholesale Services to Genuity

92. As part of our finding that the proposed spin-off of GTE's Internet backbone and related assets will not result in a violation of section 271, we also approve the transfer of control to Genuity of certain domestic and international section 214 authorizations and cable landing licenses currently held by various GTE operating subsidiaries, including GTE Telecom.[232]

[231] *Cable Attribution Order* at para. 129.

[232] These authorizations include: (1) File No. ITC-214-19990708-00391 (global facilities-based and resale authorization held by GTE Telecom Incorporated); (2) File No. SCL-98-003/SCL-98-003A (submarine cable landing license for AMERICAS-II Cable to be held by GTE Telecom Incorporated after a pro forma assignment from GTE Communications Corp.); (3) File No. SCL-LIC-19990303-00004 (submarine cable landing license for TAT-14 Cable from GTE Intelligent Network Services); (4) File No. SCL-LIC-19981117-00025 (submarine cable landing license for Japan-U.S. Cable from GTE Intelligent Network Services); and (5) ITC-98-342/ ITC-98-342A (international section 214 authorization, associated with the AMERICAS-II Cable landing license, to be held by GTE Telecom Incorporated after a pro forma assignment from GTE Communications Corp.). Pursuant to the Cable Landing License Act, the Department of State, after coordinating with the National Telecommunications and Information Administration and the Department of Defense, approved the transfer of control to Genuity of the AMERICAS-II, TAT-14 and Japan-U.S. cable landing licenses held by GTE operating subsidiaries. *See* Letter from Geoffrey Chapman, United States Coordinator, Acting International Communications and Information Policy, United States Department of State, to Donald Abelson, Chief, International Bureau, Federal Communications Commission (filed May 23, 2000).

Pursuant to domestic and international section 214 authorizations, GTE Telecom provides domestic interexchange and international wholesale services.[233] Although GTE Telecom will divest its private line, point-to-point service to commercial and financial customers before closing the merger,[234] the Applicants maintain that the transfer of GTE Telecom's wholesale services is necessary to preserve the integrity of Genuity's business.[235] Because supplying private line services on a wholesale basis to other carriers is integrally related to Genuity's business, we find that the transfer of the authorizations associated with this business is in the public interest.

93. With respect to the international transfer, we modify the international section 214 authorizations that will be transferred to Genuity, and held by its international carrier subsidiary GTE Telecom, to reclassify GTE Telecom as a nondominant international carrier on the U.S.-Dominican Republic and U.S.-Venezuela routes. After the spin-off to Genuity, GTE Telecom will no longer have an "affiliation," within the meaning of section 63.09 of the rules, with any carrier that has market power on the foreign end of a U.S. international route.[236] Accordingly, pursuant to section 63.10(a)(1) of the rules, we find no basis in this record to regulate GTE Telecom as a dominant international carrier to the Dominican Republic and Venezuela.[237]

b. Waiver of Affiliate Transactions Rules

94. We also decline to grant the Applicants' request for a waiver of the affiliate transactions rules.[238] Specifically, the Applicants seek permission to effectively treat Genuity as

---

[233] *See* GTE Corporation, Transferor, Genuity, Inc., Transferee, Application for Transfer of Control (filed Apr. 28, 2000) (Domestic Section 214 Application), at 1.

[234] *See* Letter from Alan F. Ciamporcero, Vice President Regulatory Affairs, GTE, to Magalie Roman Salas, Secretary, FCC, CC Docket No. 98-184 (filed Apr. 28, 2000), attached hereto as Appendix F.

[235] Domestic Section 214 Application at 5.

[236] *See* GTE Corporation, Transferor, Genuity, Inc., Transferee, Application for Transfer of Control of ITC-98-342/ ITC-98-342A (filed Apr. 28, 2000); GTE Corporation, Transferor, Genuity, Inc., Transferee, Application for Transfer of Control of ITC-214-19990708-00391 (filed Apr. 28, 2000). Section 63.09(e) of the rules provides, in relevant part, that: [t]wo entities are *affiliated* with each other if one of them, or an entity that controls one of them, directly or indirectly owns more than 25 percent of the capital stock of, or controls, the other one." 47 C.F.R. § 63.09(e). Currently, all of GTE's international carrier subsidiaries, including GTE Telecom, are affiliated with foreign carriers that we have found to possess market power in the Dominican Republic and Venezuela. For this reason, we have classified these subsidiaries as dominant international carriers, as appropriate under section 63.10(a)(3) of the rules, for the provision of service between the United States and each of these countries. After the spin-off and upon consummation of the merger of GTE with Bell Atlantic, all of the *Bell Atlantic-controlled* international carriers will continue to be classified as dominant international carriers on the U.S.-Dominican Republic and U.S.-Venezuela routes, as appropriate under section 6.310(a)(3) of the rules. For a detailed discussion of our international dominant carrier rules as they relate to the merged entity, *see infra* Section X.

[237] Section 63.10(a)(1) of the rules provides that: "[a] U.S. carrier that has no affiliation with, and that itself is not, a foreign carrier in a particular country to which it provides service (i.e., a destination country) shall presumptively be considered non-dominant for the provision of international communications services on that route."

[238] Petition of GTE Service Corporation and GTE Consolidated Services, Inc. for Waiver of 47 C.F.R. § 32.27(c) (filed Apr. 25, 2000) (*GTE Waiver Request*).

an affiliate for accounting purposes so that the merged firm's provision of services to Genuity through a "separate services affiliate" would not alter the manner in which the separate services affiliate provides service to other members of Bell Atlantic/GTE's corporate family.[239] By ensuring arm's length transactions between a dominant incumbent LEC and its nonregulated affiliate, the affiliate transactions rules deter potential cost misallocations and protect ratepayers of regulated services from bearing the costs of competitive ventures.[240]

95. We deny the Applicants' waiver request for three reasons. First, the Applicants fail to demonstrate special circumstances that warrant a waiver.[241] Although they claim that the waiver would only apply for a limited period of time, we note that, under the request, the separate services affiliate would provide certain services for up to a year. Similarly, the Applicants do not persuasively demonstrate that a waiver is necessary to ensure Genuity meets its operational schedule. We note that the services at issue (*e.g.*, human resources, accounting, real estate, and billing and collection) are readily available on the open market so that denying the Applicants' request does not prevent Genuity from obtaining these services in time for it to begin operations. Second, granting a waiver could result in ratepayers of regulated services directly or indirectly funding a portion of Genuity's start-up costs.[242] Finally, granting the request could have some bearing on our overall evaluation of Genuity's ownership and control. Our affiliate transactions rules apply only to incumbent LECs and their affiliates, and not to unaffiliated entities like Genuity. For these reasons, we conclude that waiving the affiliate transactions rules would be inconsistent with our findings in this order. We note, however, that Bell Atlantic/GTE may continue to provide such services, as long as it does so in accordance

[239] GTE requests permission to continue providing services to Genuity while at the same time receiving favorable accounting treatment under our rules. *See GTE Waiver Request* at 2. To accomplish this, GTE Service Corporation and GTE Consolidated Services, Inc. must continue to receive classification as a "separate services affiliate," which is an affiliate that provides services solely to members of the corporate family. Under the accounting safeguards, incumbent LECs receive favorable accounting treatment in limited circumstances involving a "separate services affiliate." *See Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket 96-150, Report and Order, 11 FCC Rcd 17539 (1996) (*Accounting Safeguards Order*). Specifically, this treatment allows incumbent LECs to value the cost of services provided by a separate services affiliate at fully distributed cost without estimating the fair market value of the services. To qualify for this favorable accounting treatment, however, the separate services affiliate must provide services solely to members of the corporate family. *See id.* Transactions with unaffiliated third parties raise the risk that ratepayers of regulated services will subsidize an incumbent LEC's competitive operations.

[240] The affiliate transactions rules prescribe the manner in which incumbent LECs record the costs of transactions between regulated and nonregulated affiliates on their books of account, and thereby help ensure that such transactions occur at arm's length. *See* 47 C.F.R. § 32.27. *See Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket 96-150, Second Order on Reconsideration, FCC 00-9 (rel. Jan. 18, 2000).

[241] *See* 47 C.F.R. §§ 1.3, 32.18; *see also Aliant Communications Co. Petition for Waiver of Section 32.27 of the Commission's Rules*, Order on Reconsideration, 14 FCC Rcd 6231 (1999); *Puerto Rico Telephone Co. Petition for Waiver of Section 32.27 of the Commission's Rules*, Memorandum Opinion and Order, DA 99-2233 (rel. Nov. 5, 1999).

[242] *See* AT&T May 5, 2000 Opposition at 7 & n.4.

with all applicable requirements.[243]

VI. ANALYSIS OF POTENTIAL PUBLIC INTEREST HARMS

A. Overview

96. In the 1996 Act, Congress determined that the public interest is served when telecommunications markets are both more competitive and less regulated. In this Order, we conclude that if considered without the supplemental conditions proposed by the Applicants, the proposed merger threatens our ability to fulfill our statutory mandate in three respects. First, the merger of Bell Atlantic and GTE decreases the potential for competition in local telecommunications markets among large incumbent LECs. Second, the proposed merger frustrates the ability of the Commission and state regulators to implement the market-opening provisions of the 1996 Act through the use of comparative practices analyses, or "benchmarking," which can assist regulators in defining incumbent LEC obligations and implementing market-opening policies under section 251, section 271, and state law in a less regulatory manner. Third, the proposed merger would increase the incentives and ability of the merged entity to discriminate against rivals in local, advanced services, and long distance markets. Specifically, we conclude that the increase in the number of local calling areas controlled by Bell Atlantic as a result of the merger will increase its incentive and ability to discriminate against carriers competing in retail markets that depend upon access to Bell Atlantic's inputs in order to provide services. Accordingly, as described below, absent the supplemental conditions proposed by the Applicants, we would conclude that the proposed merger does not serve the public interest, convenience, or necessity because it would inevitably slow progress in opening local telecommunications markets to consumer-benefiting competition, thereby requiring us to engage in more regulation, which is contrary to Congressional policy.

B. Loss of Competition Between Bell Atlantic and GTE in the Local Market

1. Background

97. We begin our review of the proposed merger by examining the transaction's likely effects on interactions between the merging firms. Until 1996, carriers seeking to compete with incumbent LECs in most geographic markets for local exchange and exchange access services had been prevented or deterred from doing so due to legal, regulatory, economic, and operational barriers. As in the *SBC/Ameritech Order*, we recognize that local telecommunications markets are evolving into markets characterized by competitive conditions and, therefore, employ an analysis that accounts for the transitional nature of those markets.[244]

---

[243] For example, GTE Service Corp. could continue to provide such services to Genuity, but it would lose its status as a separate services affiliate.

[244] *SBC/Ameritech Order*, 14 FCC Rcd at 14744, para. 63. As we have noted previously, such a transitional market analysis is relevant to the examination of a merger under the Communications Act because of our statutory obligation to promote the development, and not merely prevent the lessening, of competition in telecommunications markets. *Id.*